$50.00 ANNUALLY
40 Letters Per Year

DOW THEORY LETTERS, INC.

"The Market as Interpreted under the Dow Theory"

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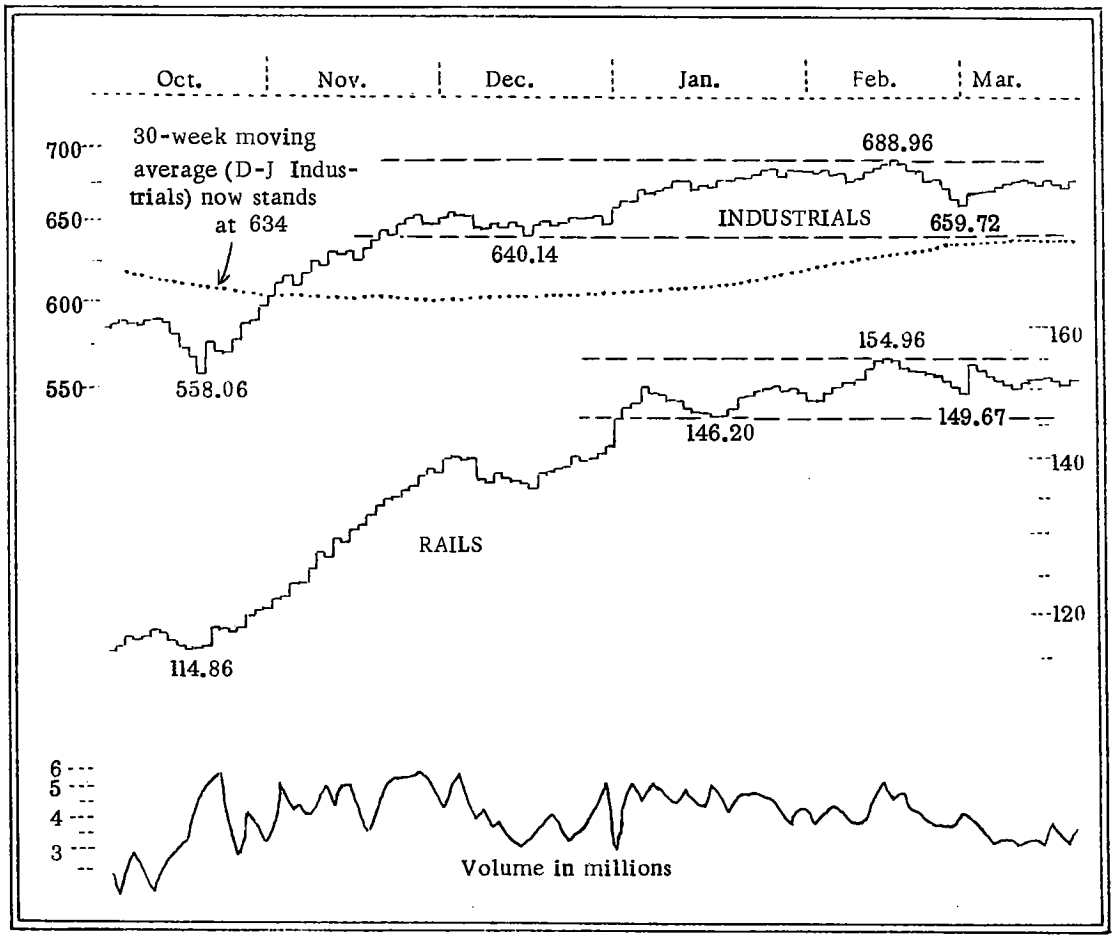
Registered with the Securities and Exchange Commission

STALEMATE The 1962 post-crash recovery took the Industrial Average to a year-end high of 653.99 (December 5). A spell of minor weakness lasted until mid-December, following which Industrials pushed up again. The highest level attained by Industrials since December 5, 1962, was 688.96, reached on February 18, 1963. This means that in the three and one-half months since December 5, 1962, Industrials have actually fluctuated within a range of 35 points or approximately 5%.

On January 8, 1963, Rails struck a post-crash recovery high of 150.52. Following a mild decline, Rails rose to a new peak of 154.96 on February 15. This means that in the two and one-half months since January 8, Rails have fluctuated within a narrow range of 4 points or approximately 3%.

With the Industrial Average now selling in the 650-680 area, a movement of 35 points appears as a wide swing on an arithmetic chart. Nevertheless, the semi-logarithmic chart on this page shows clearly that there has been little price change (in terms of percentages) since late last year. If the recent action had occurred during the 1930's or 1940's (at which time the Industrial Average sold in the 100 to 200 range), such action would have readily appeared on the charts as a "line".

"A line", wrote Robert Rhea, "is a price movement extending two or three weeks or longer, during which period the price variation of both Averages moves within a range of approximately 5%. A line indicates either accumulation or distribution. Simultaneous advances above the limits of the line indicate accumulation and predict higher prices; conversely, simultaneous declines below the line imply distribution and lower prices are sure to follow. Conclusions drawn from the movemement of one Average, not confirmed by the other, generally prove to be incorrect."



I have drawn sets of horizontal parallel lines through extremities of the December-March fluctuations in Industrials and the January-March fluctuations in Rails. Within these parallel lines, as seen on semi-logarithmic scale, a state of near-equilibrium has existed. Neither Average has,

so far, been able to push out of its range, and volume implications on both advances and declines have been inconclusive.

The situation is all the more interesting since the underlying technical situation has been more suggestive of strength than weakness. Since September of 1962 we have witnessed week after week of net odd-lot selling. The implication is that the public has been disinterested in the recovery and has, in fact, accepted the rise as a chance to get rid of stocks. Furthermore, there has been no major divergence between the Industrial Average and the advance-decline ratio, and the latter indicator of general market trend, in fact, recorded its peak on February 18 along with the Averages. Two weeks ago Barron's Confidence Index rose to 88.2, its highest level since April, 1961 (implying that bond buyers have been confident enough to move steadily into the higher yielding and more speculative end of the bond spectrum).

Under the current puzzling conditions, the investor might adopt either of two attitudes: (A) "The market should be taken 'at face value'. The technical 'underpinnings' of the market seem strong. Therefore, the investor should now sit back and wait for a potential major upward swing. Such a swing would be signalled by the two Averages' hurdling their February peaks."

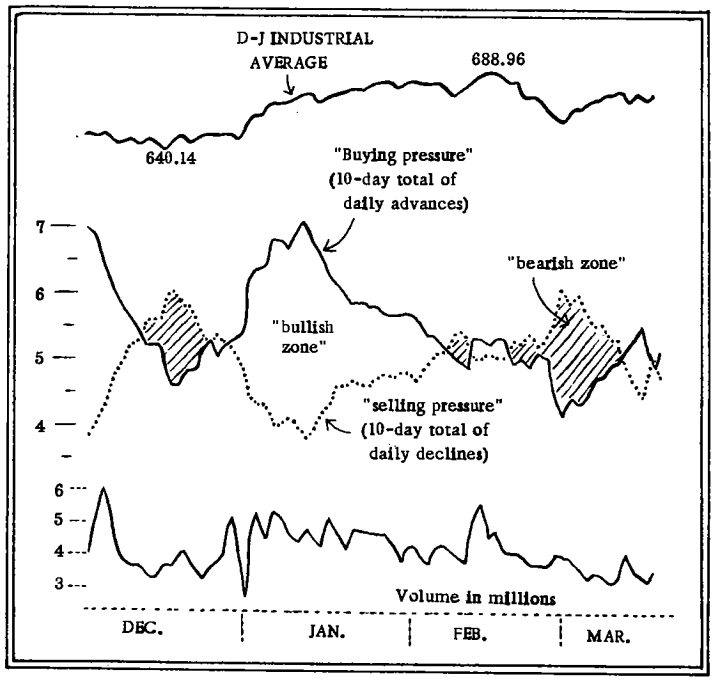
The alternate view is as follows: (B) "The market has moved sideways for four successive months. It senses "storm clouds" on the horizon, and it has stalled in the face of impending danger. Such action was last seen in 1961 when, in the face of steady odd-lot selling, the market stalled for fifteen months (September, 1961, to December, 1962), then turned down in what was to be the worst collapse since 1937."

In other words, if the two Averages hurdle the February highs on increasing volume, the "all clear" signal will have been given. On the other hand, if we are to have a repetition of 1961, we will probably see a series of "out-of-gear" movements in Industrials, Rails and the A-D ratio -- followed by a violation of the lower limits of the line on increasing volume.

I am aware that the above is in sharp contrast with some of the cocksure opinions now being bandied about. For instance, in glancing at this week's Barron's I note that a new service announces: "Here is realistic, no-nonsense counsel by market veterans...We never hedge--you are never left dangling. We spell it out for you..." (It sounds so easy I may subscribe myself).

BUYING AND SELLING PRESSURE (a continuous study) The accompanying graph clearly shows the market's indecision. At the time of the last mailing (Letter 212), the selling line was the dominant one -- but liquidating-type volume had refused to appear. For this reason I stated that "...the graph has turned negative, but not bearish." A few days later (see current chart) buying pressure rose above selling, but here upside volume refused to come in. On March 19 (for the fifth time since mid-February) the buying and selling pressure lines crossed, and this time selling pressure again assumed the dominant position.

Volume since late February has held consistently below the 4 million share mark, and it is obvious that (so far) neither the bull nor the bear side has been able to gather a "following". The next important market swing will be signaled when the lines on the graph swing out to the extremities to the accompaniment of expanding volume.



THEN AND NOW (a comparative study).

Nine months have passed since the 1962 "crash-bottom", and professional opinion is still split as to whether the 1962-63 recovery was part of a "new bull market" or a "recovery in a continuing bear market". For example, in the current issue of Forbes Magazine three of their regular market analysts have embraced various attitudes of long-term bullishness -- but the fourth, Brad Thurlow, makes the case for a full correction in a continuing bear market.

In the last Letter (212) I discussed the "channel principle" and the rationale for the "rising wedge" pattern. Basically, a rising wedge is an upward correction accompanied by steadily diminishing buying interest. When the rising wedge finally breaks, the price structure drops of its own weight (because of the complete exhaustion of buying power). As prices decline, an increasing number of stockholders become frightened and sell, and thus selling pressure begins to build up.

The 1930 recovery following the '29 crash assumed the pattern of a perfect rising wedge (see accompanying chart). The two ascending trendlines (marked A and B) formed the rising wedge pattern. When the wedge was broken in April, 1930, the resultant drop was precipitous. I have drawn a dotted line (C) parallel with line A. When the 1930 wedge was shattered, it is conceivable that the student of that day might have reasoned that the price structure was forming a large rising channel (bordered by the trendlines A and C). But when trendline C was violated in mid-1930, it was obvious that a major downward move was underway. Note that a second rising wedge formed later in 1930, and when this was broken the Industrial Average plunged below its 1929 low.

In the current situation, it seems to me that the price structure has also assumed the pattern of a rising wedge (see chart). If so, the final (bearish) proof will be a violation of trendline C. The two charts show that the patterns of 1929-30 and 1962-63 contain many similarities. The action of the market during the rest of 1963 will tell us whether those similarities are coincidental or not.

In order to demonstrate the hopelessness of attempting to "predict" the trend of the market via news items in the papers and magazines, I have included the following paragraphs which were sent to me by Dr. Sloan Wilson of Kansas City. These quotes are from The Commercial and Financial Chronicle of April 26, 1930 (at which time the post-crash recovery recorded its peak). "It is hard for me to realize that this material was not written for today," comments Dr. Wilson.

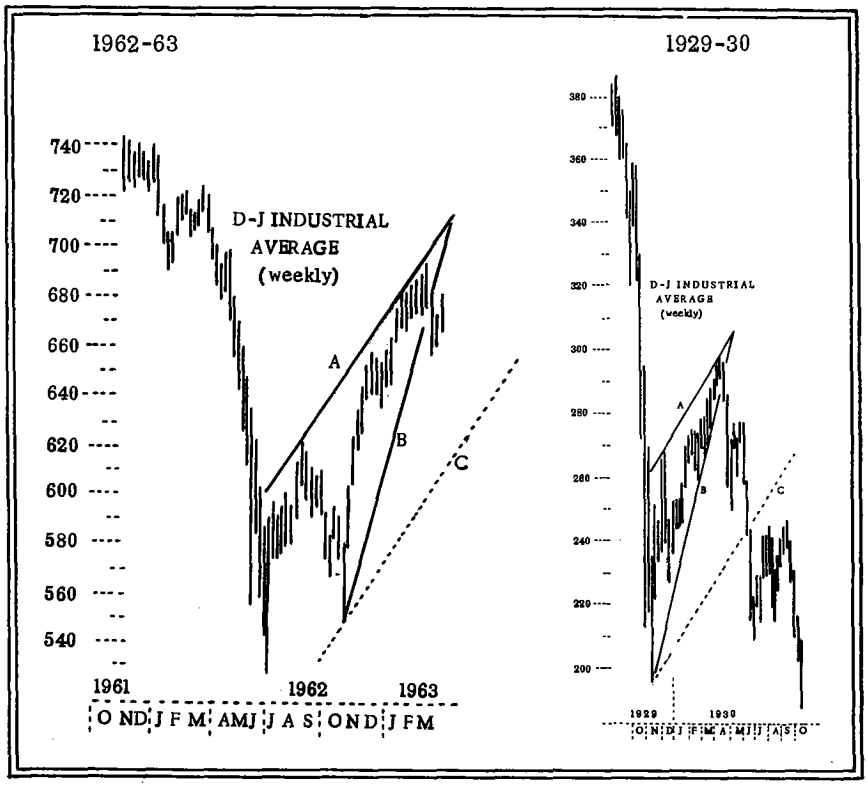
"There are many things at the present time that furnish occasion for solicitude, and not the least of these is the way brokers' loans are again expanding week after week, reflecting in this the growth of speculative activity on the Stock Exchange."

"At the present time bank credit and loanable funds are in such superabundant supply that the member banks are able to divert hugh amounts into speculative channels without being obliged to extend their borrowing at the Federal institutions."

"Weather conditions have affected trade unfavorably. It has been too cold in the Northern and Eastern parts of the United States. This has cut down business in both wholesale and retail lines. Moreover the Easter season is past. Summing up the business of the country it is partly quiet and partly on a fair scale. It is certainly nothing remarkable. Of iron and steel the production has increased somewhat, with more or less demand from the automobile trade. In heavier implements and the pipe business the sales have been on quite a liberal scale. There is a larger production of tile, auto-bodies and parts. This is at least suggestive. Following the recent decline in copper there has been some reduction in wages in that industry.....The output of automobiles in March turns out to have been 401,378 cars and trucks, the largest total since last September.'

"In Boston and New England business is said to be on the upturn and sentiment is better. It is felt that April and May will make a better showing than March."

"Fortunately, new financing is proceeding on an exceptionally large scale, and thus the means are provided for furthering new enterprises and new undertakings of one kind and another, as also to take care of extension and improvement work in various directions. This alone should contribute most powerfully to bring about the trade revival under discussion."



SUNDRY COMMENTS A N.Y.C. subscriber says: "I read with interest your Letter 211, and particularly the line, 'it occurs to this writer that the 1962 collapse may have been discounting political and social (as well as economic) shifts which even now are not fully understood.' "

The subscriber continues: "Even if some amazing development occurred next month -- let's say renewed threat of war with Cuba -- you name it -- no matter how dramatic any upcoming social, economic or political development might be, I would find it hard to believe that a substantial number of informed investors were able to anticipate these developments last

April -- and by acting on their belief -- overwhelm the market with an outpouring of stock. Three months foresight -- of course. Six months -- most probably, particularly if the event were of great magnitude. A year -- highly likely."(L. Becker, N.Y.C.).

Perhaps, but writing of the bull market of 1908-09, Hamilton noted: "The (1907) depression was recognized; but the fact that the stock market was acting not upon the things of the moment but upon all the facts, as far ahead as it could see them, was never allowed to become obscure. A well known chart showed its lowest point of depression in January, 1908, and did not cross its medial line, to begin its ensuing area of expansion, until the following November. But the stock market anticipated that record by a clear twelve months, and the faithful barometer predicted the recovery when there was apparently not a patch of clear sky on the horizon."

Many intelligent men are (and have been) wary of the trend of events for well over a year. For instance, economist Eliot Janeway sees "a major peril ahead" in our Government's policy of placing special, non-marketable, short-to-medium term dollar notes with Foreign Central banks. "What this means," he says "is that we have begun to incur short-term foreign debt, callable overnight, as an attempted solution to our long-term international balances. This is a pyramiding of risks -- political, financial, psychological -- reminiscent of the reckless piling up of short-term inter-Governmental debt at the crest of the boom of the 1920's."

Then, in a personal note to me Mr. Janeway states: "The market, as you say in Letter 211, does discount the political and social, as well as the economic and financial. And I can't say strongly enough, it discounts the international as well as the domestic. The international is all bearish, and I believe that this is the dominant force."

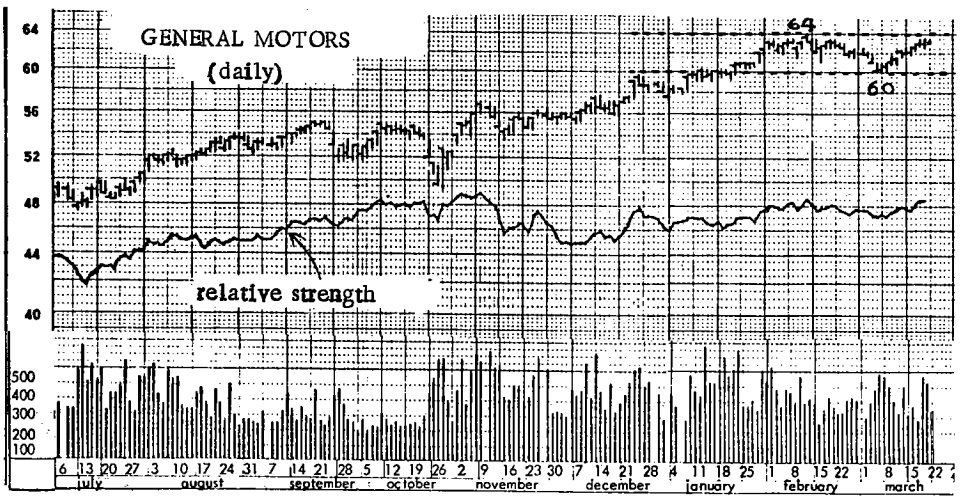
Personally, I continue to view the 1962 crash as a definite (early) warning for investors. The cracking of the great thirteen-year ascending trendline (see Letter 211) cannot be taken lightly -- nor can I dismiss the hugh liquidating volume of May, 1962. A ship's barometer may drop sharply, then rise just as quickly within a few hours. The veteran sea captain knows that the barometer is far from infallible, but he has learned never to ignore its warning signal (particularly when it has been a long time between storms).

LATE NOTES (Written Thursday, March 21, 12 noon, N.Y. time). Yesterday's sharp rally served to put buying pressure above selling pressure (see page 2 chart) for the sixth reversal since mid-February. Today additional buying came in, but (despite the announcement of a slight increase in the total short interest) the upside action was unimpressive. The market remains trendless and stalemated.

STOCKS Of 350 representative stocks which are tabulated weekly at this office, 239 (68%) are holding above their 30-week moving average (an improvement of 4% over last week). Of the same stocks, 178 (51%) are above their 1962 recovery highs (an improvement of 2% over last week).

From a relative strength standpoint, more stock groups appear weak than strong. Among stronger groups are autos, finance companies and farm equipment. Weaker groups include aircraft, aluminums, business machines, machinery, steel.

Over the past six months General Motors (chart below) has probably been the recipient of more good news than any other stock on the board. GM hit a peak of 64 in mid-February. This stock is so important that a move to a new high could conceivably spark the Industrial Average to further gains. On the other hand, if GM turned down and broke 60 I would think that the whole market could be heading for trouble. Note that GM's relative strength (despite constant favorable news) has not improved since November of last year. (Note: Knowledgeable friends of mine from New York tell me that they have been buying GM and consider it the most underpriced -- if not the only underpriced -- stock in the Industrial Average. In view of this, it will be even more interesting to see whether this leading "blue-chip" equity, an equity that has been bombarded with good news, can "move out" on the upside. My personal belief is that "if GM doesn't rise and shine -- nothing will).



Charts on this page courtesy of Traders Research, P. O. Box 2466, St. Louis 16, Missouri.